Narrative Report on Germany

PART 1: NARRATIVE REPORT

Germany is ranked 14th in the 2020 Financial Secrecy Index (FSI), based on a moderate secrecy score of 52 (compared to 59 in 2018) combined with a large global scale weight: Germany accounts for over 4.71% per cent of the global market for offshore financial services. Compared to 2018, Germany was the Top 10 country with the biggest improvement in rank (+7) followed by Taiwan (+5) and Guernsey (+2). This is mainly due to the improvement in the ownership registration score (-24.5) and small improvements in legal entity transparency (-3) and in integrity of tax and financial regulation (-1.7).

Besides international cooperation and the enhanced exchange of information, the German government implemented various improvements in the fight against money laundering and tax dodging mandated by the EU at the end of 2019. These included among others:

- Making the beneficial ownership register accessible for the public and searchable for law enforcement (but failed to make it open-data).
- Obliging tax consultants, other service providers and companies to report cross-border tax models (but leaving out national models).
- Public endorsement of public country-by-country reporting by the finance minister and the preparations to make anonymized country-by-country data accessible to scientists.

Nevertheless, serious gaps with regard to corporate ownership transparency (including the continued existence of bearer shares), loopholes in legislation and weak enforcement of anti-money laundering and tax regulations remain a big issue.

Frankfurt as an important regional financial center struggling for global eminence

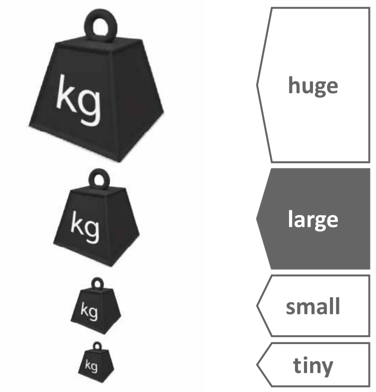
Frankfurt, Germany's modern financial powerhouse, was one of the most important cities in the Holy Roman Empire, and for much of that time it was the most economically powerful city in the region. After ups and downs it regained prominence as Germany's financial center when the central bank set up its HQ there in 1957 followed by several banks such as Dresdner Bank and Deutsche Bank. The role of banks in Germany was traditionally counter-balanced and limited by a strong industrial sector. Faced with quite strong domestic regulations in the Bretton Woods era, German banks therefore shifted substantial operations abroad, particularly into the deregulated "Euromarkets" – notably the City of London and Luxembourg in the 1960s and 70s (see their respective offshore histories here and here).[1] [2] Lobbying for financial liberalization at home they helped to attract global banks and by the mid-1980s, 40 of the world's top 50 banks had a presence in Frankfurt and four fifths of foreign banks in Germany had chosen Frankfurt as their base (p178 of European Banks and the American Challenge).[3] This history has repeated itself in the 90s with Deutsche Bank heading efforts to further globalize their business and benefit from laxer rules abroad, especially in the US, and, much later, Frankfurt trying to attract bankers from London after Brexit. More recently Deutsche Bank has faced huge fines for its involvement in money laundering, market manipulation

Rank: 14 of 133

How Secretive? 52

Moderately secretive	0 to <25
	25 to <50
	50 to <75
Exceptionally secretive	75 to 100

How big? 4.71%



Germany accounts for 4.71 per cent of the global market for offshore financial services. This makes it a large player compared to other secrecy jurisdictions.

The ranking is based on a combination of its secrecy score and scale weighting.

Full data is available here: http://www.financialsecrecyindex.com/database.

To find out more about the Financial Secrecy Index, please visit

http://www.financialsecrecyindex.com.

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and sanction busting and the Panama Papers proved active promotion of illicit activity by several German banks.

A long history of fighting tax evasion at home while attracting flight capital from abroad

The government's "Tax Haven Report" ("Steueroasenbericht") of 1964 and the relocation of a prominent business man (Helmut Horten) to Switzerland to dispose of his company assets tax-free resulted in a law trying to tackle tax flight in 1972 (Außensteuergesetz) including an exit tax and new legislation on controlled foreign corporations.[4] The law continues in force with several amendments but due to restrictions by EU law as well as intensive tax planning the resulting tax collections remain very small. In the 1980s and 90s Germany saw various big tax scandals involving secret accounts and illegal party donations via Switzerland and Liechtenstein involving several of the political parties then in parliament, big companies and famous sports stars. In 1984 Germany abolished a tax on state bonds levied on non-residents ("Couponsteuer"), enabling tax evaders to invest free of cost in Germany's financial system (p.264).[5]

A few years later, in 1993, and following an unsuccessful amnesty, Germany introduced a law that would tax previously largely untaxed interest income at the source, leading to huge capital flight to Luxembourg and Switzerland. The role of various big German banks, especially the Commerzbank, was later exposed thanks to a whistleblower but never fully prosecuted. Towards the end of the 90s, the German intelligence agency helped to acquire one of the first in a series of data sets exposing tax evasion via Liechtenstein and Germany was one of the first countries to introduce a centralised bank account register in 2003. The exemption of interest income for foreigners remains in place until today, repeatedly justified by the interest of the German financial market.

Origins and evolution of a federal system of tax collection and intra-German tax competition

Attempts by the constitutional convention after the Second World War to set up a central tax administration (that had just been introduced in the 1920s), were thwarted by fierce opposition from Allied powers. The result was a fragmented tax administration accountable to each of the now 16 Bundesländer (subnational states of Germany), but not to the central government. This has created a badly flawed incentive structure: the 16 states bear the costs of tax administration and tax audit, but they have to pass on much of the extra tax revenue to other states or central government.

This has repeatedly served as an excuse to engage in ruinous intra-German 'tax wars' for lax enforcement, auditing and the hiring and staffing of local tax authorities.[6] This kind of laxity is another classic 'tax haven' staple.[7] Tax rates are also subject of intra-German competition at the parish level. Until a minimum rate of 7% was introduced in 2004, municipalities could freely set the "business tax" known as Gewerbesteuer, which makes up approximately half of the corporate tax rate on average. As a result, tiny German municipalities such as Norderfriedrichskoog in the far north near the Danish border with fewer than 50 inhabitants used a rate of zero to attract over 300 companies, including affiliates of Deutsche Bank, Eli Lily & Co., Lufthansa and the German utility E.ON. As a consequence, corporate limousines trailed its muddy tracks to have 'meetings' in makeshift boardrooms built at the backs of farms once every year. Nevertheless parishes in structurally weak regions or around big cities continue to attract corporate business through lower tax rates, exemplified by Deutsche Börse's relocation from Frankfurt to nearby Eschborn in 2010 which helped to cut its tax rates sharply.[8]

Recent improvements in ownership registration and transparency

The adoption of the 5th AMLD has improved the provisions for the German beneficial ownership registry which are now (largely) in line with the EU minimum standards. Thanks to big public pressure around money-laundering in real estate, Germany was one of the first countries to introduce a requirement for foreign real estate buyers to register in Germany. However, ownership registration continues to have serious gaps and limitations:[9]

- Lack of user-friendliness and user protection: The public registry continues to levy a charge of €1.98 per request and the information is neither provided instantly (but only after approval) nor in a machine-readable or machine-searchable form. This will impede effective investigations. In addition, users have to register and their information requests and identity can be revealed to the beneficial owners on request. This might serve as an early warning for criminals and expose the investigators to attempts at intimidation. Searching for names of beneficial owners is not possible but at least the law enforcement agencies (and especially the FIU) will get access to the raw data to enable such searches. Furthermore, early checks of the register's data have revealed a surprisingly high frequency of absence of any recorded beneficial ownership information, prompting doubts about the interpretation, implementation and enforcement of the legal provisions.

- High beneficial ownership thresholds: A beneficial owner below the reporting threshold of more than 25% will not be included in the register. This provides an unnecessary incentive for circumvention.

- Vague formulation in case of non-identifiable owners: The reporting obligations of companies have been improved but the obligation to enquire unknown beneficial owners is still too weak. For example, the company has to enquire from its shareholders about the beneficial owners only "insofar as the shareholders are known, to an adequate extent" (§20.3A GWG).[10] For the beneficial ownership register to be effective, the full control and ownership structure needs to be reported. If companies fail to identify their beneficial owners, they should be obliged to provide an unequivocal explanation or be required to dissolve the legal entity.

- Insufficient information on the real estate sector: foreign buyers of real estate only need to register if they are not from the European Union and only for future acquisitions (after 2019). This represents an important loophole in the fight against money laundering. Information about legal owners of real estate can only be obtained on-site in the regional (or sub-regional) land registries and digitalization of these registers initially planned for 2018 has been postponed to 2024.[11] The lacking digitalization and therefore the impossibility to link it to the beneficial ownership register prevents a systematic investigation of ownership networks. As a recent example, even the Berlin senate, in an attempt to identify all real estate owners with more than 3.000 apartments, failed to identify three brothers from the UK who own nearly 6.000 apartments in Berlin through a network of shell companies in Luxembourg, Denmark, Cyprus and British Virgin Islands.[12]

- Bearer shares: Due to the existence of bearer shares some information in the beneficial ownership register is at risk to be outdated (see below). Bearer shares are share certificates which do not include the name of the shareholder. The name of the initial shareholder should be recorded in the company's share register but the bearer share can be transferred to another person without updating the shareholder information. The anonymous transfer of shares helps to obscure legal and beneficial ownership and therefore undermines financial transparency. Since 31 December 2015 only publicly traded companies are allowed to issue bearer shares but bearer shares of non-listed companies issued before that date continue to exist and there is no deadline for registering bearer shares and updating ownership information. According to the Global Forum, more than 14 000 non-publicly listed AGs and KGaAs were allowed to issue bearer shares, but the number of bearer shares actually issued is unknown.[13] Even if some ownership information might be disclosed due to new tax reporting requirements, there are no provisions to update this information after the transfer of shares. Tolerating these outdated ownership information threatens the effectivity of public ownership registries.

- Unregistered legal entities: Germany continues to have a widely used form of a partnership (GbR) without any registration requirements.

- Quality of the data: The German BO register exists in parallel and in addition to the corporate register but unlike the latter does not require the check of a notary and therefore information there doesn't have the same legal status ("öffentlicher Glaube"). Due to the difficult access journalists could so far only uncover few examples for the questionable quality of the data.

Looking beyond ownership registration, Germany implemented the internationally agreed reforms such as automatic exchange of information and country-by-country reporting for multinationals. These are important steps towards more fiscal and financial transparency. Germany is one of a few countries that requires robust local filing of country-by-country reports. So far, no CbCR data has been made public and Germany was one of 15 European countries (incl. notorious corporate tax havens such as Cyprus, Ireland, Luxembourg and Malta) failing to support the EU directive for mandatory public CbCR.[14] Despite this inaction, the finance minister has publicly changed his position on the matter. A law for the publication of aggregate CbCR data via the national statistical office is on the way.[15]

German companies also have to publish their annual accounts in a central depository that is accessible free of charge since 2012. Nevertheless, a significant share of companies, including some of the biggest, as well as foundations and other legal vehicles are exempted either from filing any financial statements in Germany (if consolidated in a European company's accounts) or from the duty to publish profits and tax payments.

Still an attractive destination for dirty money

As a big and stable economy and with intensive use of cash and a booming real estate sector, Germany attracts substantial money laundering activities. Even though no reliable numbers on the extent of money laundering exist, experts agree that the problem is significant and that the fight against money laundering is not yet very effective in Germany.[16] It is estimated that €29-109 billion from national and international criminal activities might be laundered in Germany every year. The most widely quoted estimate of €100 billion is extrapolated from suspicions recounted (but not verified or even necessarily reported) in interviews with obliged entities from the non-financial sector and topped-up to comprise the financial sector. Lower estimates are based on national crime statistics but exclude tax evasion.[17] At the end of 2019, Germany has finally published its first national risk analysis (NRA). But this risk analysis doesn't contain any official estimate on the size of the problem and the analysis of sectoral and country risks in many cases seems to lack rigorous analysis and evidence. Even though estimates are highly uncertain, the national risk analysis as well as anti-money laundering experts and individual cases brought up by the media indicate that the problem is substantial. In the last two years money-laundering received increased public attention, especially around real estate transactions.[18]

There are still relatively few known cases of illicit financial flows from developing countries ending up in Germany and consequently hardly any returned illicit assets. But this could be the result of very little transparency around money-laundering cases (court documents are often not publicly accessible and existing cases are usually recorded only with respect to the predicate offense so statistical information is not useful), limited capacity for more complex investigations and in many cases weak enforcement of anti-money laundering rules in general. An analysis of publicly available information and big money-laundering investigations globally found several potential or proven links to Germany that have apparently not been followed-up.[19] In addition, tax evasion is a predicate offence for money laundering purposes only if committed in a criminal network or commercially ("von einem Mitglied einer Bande" or "gewerbsmäßig") and the NRA rightly complains that in practice this distinction is very difficult to make, offering an all too easy excuse for inaction.

In 2017, the Financial Intelligence Unit dealing with reported suspicions of money laundering was moved from the Federal Criminal Police Office to the Federal Customs Authority and media reported widely about various failures of the restructuring process, including lack of access to information, software problems and the lack of qualified staff hampering the effective functioning of the FIU.[20] There were also reports of big case backlogs of up to 20,000 unresolved reports, even including time-sensitive cases involving temporary bank freezes (17 out of 865 cases between October 2018 and January 2019 according to official numbers).[21] On the more positive side, staff is gradually increasing from 162 positions in January 2019 towards a total 475 positions.[22] Towards the end of 2019, according to unofficial sources, 263 positions were occupied and the authority was relying on additional support from 161 customs officers. In 2018, roughly 2 % (275) of the reports forwarded to law enforcement and prosecutors have resulted in court convictions, penalties or indictments.[23]

Anti-money laundering supervision in the non-financial sector is highly fragmented among more than 300 different agencies, which often lack the required capabilities and cooperation to enforce AML rules effectively. As a consequence, suspicious transaction reports from and fines in the non-financial sector are rare. In 2018, the FIU received 77.252 suspicious activity reports of which 750 were directly related to real estate but only 39 were reported by real estate agents, notaries or lawyers involved in real estate deals.[24] This situation is set to change due to increased public attention and the FATF review scheduled for 2020, leading several federal states to strengthen their supervisory agencies, and due to a provision of the implementation of the 5th AMLD that makes it easier for notaries and others to report suspicions despite their legal privilege.

Supervision in the financial sector is centralized with the bank supervisory agency (BaFin) who continues to outsource most of the supervision to private auditing firms. For example, following the revelations of the Panama papers showing the involvement of German banks in setting up offshore companies in Panama and BVI for their clients, BaFin hired external auditors from Fides Treuhand that came to the conclusion that banks had largely complied with anti-money laundering regulation[25].

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As another example, Deutsche Bank – after several money-laundering investigations and punishments and under scrutiny of a special representative appointed by Bafin[26] (this time from Deutsche Bank auditor KPMG) – apparently had to get rid of several thousand of its 20,000 high risk investment bank clients because it was not able to obtain the required confirmation of their identity on time.[27] In addition, the relatively low fines (the highest fine of EUR 40 m was awarded against Deutsche Bank for its involvement in CO2 certificate fraud) and low number of convictions relating to failures to prevent money laundering by banks and other institutions point to weaknesses in the policing of anti-money laundering rules. BaFin has recently started to increase its personnel for on-site audits and the NRA reports some first positive experiences.

Tax agencies with more data but continuing capacity constraints

Some German states have in the past purchased data from whistleblowers (especially from banks in Switzerland, Luxembourg and Liechtenstein) and the police has bought data from various leaks including the Panama Papers, the Paradise Papers and others and is analyzing this data together with tax officials. In addition, new reporting requirements and international exchange of information provide the tax administrations with unprecedented amounts of new data on corporate tax planning and residents' foreign assets:

- The automatic exchange of information under the Directive on Administrative Cooperation and under the Common Reporting Standard should provide tax authorities with information on taxpayers' foreign income and wealth and thus reduce the scope for cross-border tax evasion. As of February 2020 Germany has concluded 99 ingoing and 71 outgoing exchange agreements.[28] The Federal Central Tax Office has already received and sent millions of datasets under both regimes (Council Directive 2014/107/EU, CRS) e.g. in 2017, under the CRS, Germany has received information on EUR 483 bn of foreign bank deposits and EUR 413 bn of capital income. But the government does not know and doesn't seem to have any estimate of how much of the German foreign assets from Germany continue undeclared.[29] Alstadsæter, Johannesen and Zucman have estimated that German residents hold about USD 552 bn of wealth in tax havens alone - but these estimates do not only include bank deposits but also the stock of portfolio investment, i.e. they are not directly comparable to the numbers on derived capital income provided by the German government.[30] Under the CRS, Germany has shared information on EUR 139 bn of bank deposits and 427 bn of capital income received by residents of other countries. [31]

- Reporting obligations for ownership of shell companies require banks and other intermediaries assisting in setting up shell companies to report those to the fiscal authorities. This requirement was introduced as a direct consequence of the Panama Papers in 2017. Unfortunately, the reporting requirements were limited to companies created outside of the EU and the European Free Trade Association (EFTA), failed to include important intermediaries such as lawyers and tax consultants, and carry only very limited fines and no statistical reporting requirements for the German government to check the success of the law's implementation. For this reason, the law was considered to be seriously flawed already at the time of its introduction.[32]

- Country-by-country reports by multinational corporations should enable the tax administrations to better understand the global distribution of corporate activity, profits and taxes paid and check the plausibility of the tax declarations. So far, Germany has entered into bilateral exchange agreements with 62 jurisdictions, among which very few lower income countries.[33] In 2016 and 2017, the Federal Central Tax Office has received 400 reports p.a. from German corporations and shared them with other countries. It has received information on about 2000 foreign companies by other countries. The Federal Government does not know if the tax administrations have used this information to initiate additional tax audits.[34]

- The new reporting obligation for intermediaries in the tax planning business was introduced in October 2019 and requires intermediaries such as banks, tax advisors, and lawyers to report cross-border tax planning models which they developed or sold to their customers. The information will also be exchanged internationally and should help the tax administrations to identify aggressive tax planning and stop tax evasion by multinational companies.[35] Despite long discussions the extension of these requirements to national models was dropped during the adoption process.

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The collection and exchange of the data can be regarded as a milestone in the fight against international tax evasion. Still, it remains to be seen to what extent the administrations will be able to effectively process the data, to detect and prosecute tax evaders. The Federal government has created 80 new positions in the different authorities dealing with the new data, mainly in the Federal Central Tax Office. However, not all positions are occupied yet and the regional tax authorities which will ultimately have to make use of the data in audits and tax investigations remain heavily understaffed. In addition the German tax authorities have repeatedly been criticised for their fragmented, low-tech and under-resourced approach to collecting tax, especially from wealthy people, and for having inadequate means to deal with large taxpayers.[36]

Decades of cut backs in the public sector have produced a situation of lax tax enforcement in Germany which is still unresolved. Between 2009 and 2018, fiscal authorities have reduced their staff by about 4.000 full-time equivalents. In addition, the number of unfilled positions has increased constantly and has reached nearly 6.000 in 2018.[37] The number of tax auditors and investigators has remained constant despite an estimated understaffing amounting to 3.000 auditors and 500 tax investigators as estimated by the service sector trade union ver.di in 2017. The audit frequency of companies (especially smaller ones) has remained constant over the last 10 years but the additional revenues from audits have declined by 30 per cent. The audit rate of individual taxpayers with income of more than EUR 500.000 has declined from 15 in 2009 to 10 per cent in 2018. Also, the numbers of special sales tax audits and external wage tax audits have declined significantly. Special units for high-income taxpayers do not exist in all federal states or at the federal level.[38] In addition, the public is usually excluded from court deliberations and sentences on tax matters and court documents on tax cases are usually not accessible to the public or even for research. This prevents the public from effectively exerting oversight over the rule of law because the information is lacking for holding the government, administration and courts to account for their practices on tax.

Another problem is the fragmented regional system of tax collection and tax IT which hinders exchange of information between the federal states. The introduction of a uniform nationwide IT system was initiated in 2007 but has not been delivered so far. Recently, the Federal Audit Office has criticized significant delays in the process and requested a human resources strategy to deal with the persisting lack of IT specialists.[39] According to a report by the European Commission, Germany was one of the last countries to start analyzing information exchanged under its first three Directives on administrative cooperation in the field of direct taxation[40] ("DAC" 1 – 3) and the federal tax agency that receives the information has only started to implement the IT-software that distributes the information to the tax agencies at federal level responsible for actually using them in 2019.

The final report by the committee of inquiry on "cum-ex" trades sheds a bad light on the influence of the finance lobby in drafting national legislation and enforcing regulations. Over decades, the government failed to stop banks and super-rich investors from extracting billions of tax revenues with a trick related to short sales of shares around the dividend payment date and claiming multiple refunds for taxes that were only paid once. It turned out that the explanatory memorandum of a legislative change, which contained severe loopholes and was thus ineffective in addressing the problem, had been drafted by the banking association and had been uncritically adopted by the government. Far from putting an end to the revenue losses which would continue for several more years, this memorandum served to seemingly legitimise the trades.

Since 2014, several financial courts have found "cum-ex" to be illegal even under the flawed law. In 2019, the first criminal trial on cum-ex started based on crown-witnesses and evidence from leaked data CDs, revealing how financial institutions and professional enablers colluded to manufacture the complicated trading schemes. In the related "cum-cum" scandal, German banks collaborated with foreign investors to avoid billions of due taxes and share the gains. In total, estimated tax losses due to the "cum-ex" and "cum-cum" trades accumulated to about €34.6 billion.[41] So far, €2.4 billion of the €10-12 billion due to cum-ex trades have been recovered but several cases might be prescribed already. Official numbers regarding damages from cum-cum do not exist. The government has announced the formation of a task force at the Federal Central Tax Office to prevent tax fraud on the capital market in the future.[42]

With thanks to Sarah Godar & Christoph Trautvetter

Endnotes

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Germany

PART 2: SECRECY SCORE

OWNERSHIP REGISTRATION

- 50 — 1. Banking Secrecy
- 25 — 2. Trust and Foundations Register
- 75 — 3. Recorded Company Ownership
- 100 — 4. Other Wealth Ownership
- 60 — 5. Limited Partnership Transparency

LEGAL ENTITY TRANSPARENCY

- 100 — 6. Public Company Ownership
- 100 — 7. Public Company Accounts
- 50 — 8. Country-by-Country Reporting
- 35 — 9. Corporate Tax Disclosure
- 75 — 10. Legal Entity Identifier

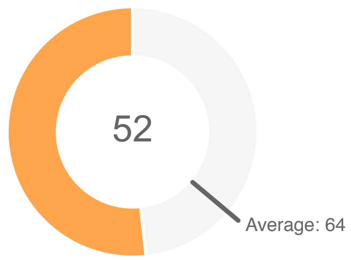
INTEGRITY OF TAX AND FINANCIAL REGULATION

- 65 — 11. Tax Administration Capacity
- 0 — 12. Consistent Personal Income Tax
- 30 — 13. Avoids Promoting Tax Evasion
- 100 — 14. Tax Court Secrecy
- 75 — 15. Harmful Structures
- 30 — 16. Public Statistics

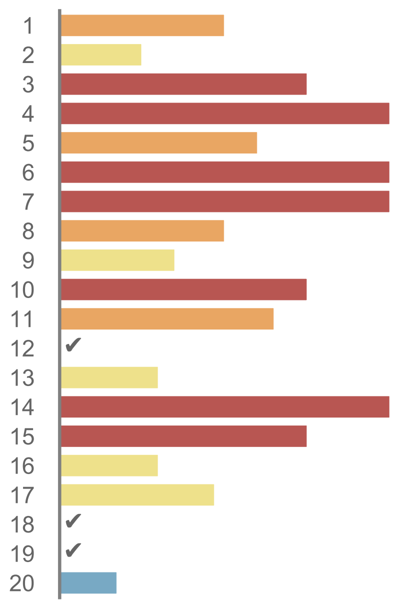
INTERNATIONAL STANDARDS AND COOPERATION

- 47 — 17. Anti-Money Laundering
- 0 — 18. Automatic Information Exchange
- 0 — 19. Bilateral Treaties
- 18 — 20. International Legal Cooperation

Secrecy Score



Key Financial Secrecy Indicators



Notes and Sources

The FSI ranking is based on a combination of a country's secrecy score and global scale weighting (click here to see our full methodology).

The secrecy score is calculated as an arithmetic average of the 20 Key Financial Secrecy Indicators (KFSI), listed on the right. Each indicator is explained in more detail in the links accessible by clicking on the name of the KFSI.

A grey tick in the chart above indicates full compliance with the relevant indicator, meaning least secrecy; red indicates non-compliance (most secrecy); colours in between partial compliance.

This report draws on data sources that include regulatory reports, legislation, regulation and news available as of 30 September 2019 (or later in some cases).

Full data is available here: http://www.financialsecrecyindex.com/database.

To find out more about the Financial Secrecy Index, please visit http://www.financialsecrecyindex.com.